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SENSITIVE
SIPDIS

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SUBJECT: IMF PROGRAM HITS ROUGH WATERS IN THE MALDIVES

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¶1. (SBU)SUMMARY: An IMF staff mission is currently in the Maldives reviewing progress toward IMF benchmarks before releasing the second tranche of funds. The review will be difficult. The IMF negotiated a very tough agreement with the Maldives with ambitious deficit-reduction targets. The Government of the Maldives, in large part due to a difficult political situation, has been fighting to keep government wage reductions in place but has increased electricity rates. There has been limited progress in other areas to reduce government positions and increase revenue through new taxes. Top government officials hope that the IMF will be tolerant with the Maldives. Indeed, due to limited tax-collection expertise, the Maldives needs time to begin realizing revenue, even when (or if) the new taxes are approved by the Maldivian Parliament. END SUMMARY.

IMF Review Mission

¶2. (SBU) An IMF staff mission is in the Maldives February 9-22 to conduct its first review under the IMF program whether the Maldives is meeting its performance criteria, indicative targets, and structural benchmarks. The results of the review will be completed by March for the IMF board to vote whether to release the second tranche of IMF funds. The IMF has agreed to provide a readout of the staff mission to post.

Tough Love from the IMF

¶3. (SBU) The January 2010 IMF Staff report recounts how far the Maldives has gotten off track since 2004. "Government expenditures almost doubled as a share of GDP between 2004 and 2008 and, without adjustment, are on course to reach 69 percent of GDP by end 2009. A key driver has been the wage bill, stemming from large wage increases and a build-up in the number of public-sector employees (public employment and the wage bill are now very high by international standards." Indeed, the IMF projects that, without adjustments, the GOM budget deficit will be 33 percent of GDP in 2009, 28 percent in 2010, and stretch out to over 20 percent deficit-to-GDP ratio through at least 2014.

¶4. (SBU) The IMF negotiated a very tough adjustment program

with the Maldives, which the IMF estimates will reduce government deficit to GDP ratios from 33 percent in 2009 to 18 percent in 2010 and 4.25 percent in 2011. As a precondition to the IMF agreement, on October 1, 2009, the Civil Service Commission of the Maldives agreed to cut government salaries by an average of 14 percent. Under the agreement, the pay rates will be restored when the GOM domestic revenue reaches 7 billion Rf (approximately 55 million USD), which the IMF projected would occur in 2011. IMF Representative Dr. Koshy Mathai agreed that a wage cut was extraordinary for an IMF program, but the ballooning wage bill forced the IMF to require this precondition. The GOM also agreed to reduce 9,000 'redundant' government employees (out of over 30,000 total) by the end of 2010. The original IMF staff report estimated that wage and staff reductions would decrease the government's wage bill from 28 percent of GDP in 2009 to 17.5 percent in 2011.

¶5. (SBU) The IMF projects that its program will reduce the GOM budget deficit by 14.6 percent in 2010, 20.8 percent in 2011, and 18.8 percent in 2012. On the expenditure side, the IMF program counts on the wage reduction for 3.7 percent of GDP reduction in 2010, but by 2011 wages are to be restored. The IMF projects that cutting staff redundancies will contribute 4.2 percent of GDP and increasing electrical tariffs will chip in 2.5 percent of GDP. On the revenue side, the IMF expects an airport tax and business profits tax to be implemented by year end 2009, an ad valorem tax on tourism by October 2010, and a general sales tax by 2011. The IMF is counting on the airport tax raising 0.9 percent of GDP, the business profits tax contributing 1.6 percent of GDP

in 2010 and 2.9 percent thereafter, the ad valorem tax increases revenue by 1.1 percent of GDP in 2010, and approximately 5 percent of GDP thereafter. The general sales tax should start generating 2.3 percent of GDP revenue in ¶2011.

IMF Program Hits the Reality of the Maldivian Political System

¶6. (SBU) The Government of the Maldives has been at a stand-off since parliamentary elections in May 2009, which resulted in the opposition party winning two more seats in parliament than President Nasheed's party. President Nasheed sincerely wants to push through many market reforms, but most of his plans have been stymied by the opposition. The parliament has only passed one bill related to the economic crisis since the 2009 parliamentary elections (to increase the airport departure tax).

¶7. (SBU) Government salary reductions, an absolute precondition of the IMF program, have become embroiled in local politics. Ahmed As-Ad, Minister of State for Finance and Treasury, told econoff that with the GOM proposed budget would have a 14.8 percent government deficit, but if the wages were restored, the deficit would increase to 19 percent of GDP. The Civil Service Commission of the Maldives has claimed that the projected government revenues have reached 7 billion Rf, so the wages should be restored immediately. The Parliament also supports restoring the wages and did so in the budget. The Ministry of Finance has held firm, insisting on the wage reductions, despite a demonstration outside the Ministry of Finance led by the Civil Service Commission.

¶8. (SBU) The GOM has also hiked electricity rates by 33 percent, which should account for a 2.3 percent reduction in the government deficit. The GOM has a subsidy program, permitted under the IMF program, but consumers are clamoring for additional subsidies.

¶9. (SBU) There appears to have been little progress in staff reductions, although the IMF expects 9,000 staff reductions by the end of 2010. Ministry of Labor officials are developing a plan to offer staff different severance packages to leave government service, including substantial loans, long-term training, or help to establish a small enterprise.

The GOM hopes to receive donor assistance to finance the severance program, but Ministry of Finance officials said that the World Bank was reluctant to do so because they have had poor repayment rates for similar loans in other countries. (NOTE: The GOM is holding a large donor's conference on March 28 in the Maldives to coordinate and seek assistance. END NOTE.) Therefore, GOM staff reductions are still very much in the planning stages. As described in reftel, staff reductions will be very difficult politically when the GOM employs over 10 percent of the citizens of the Maldives, and a much higher percentage of the voting age population (see reftel B). Vice President Mohamed Waheed commented that it would be very difficult for the private sector to absorb all of the excess government workers. Other post contacts have pointed out that many government workers wwould be reluctant to leave their secure employment in air-conditioned offices in Male for work on the resort islands.

¶10. (SBU) Aside from the airport tax, the GOM has promised to implement a business profits tax and an ad valorem tax on tourists. The GOM has implemented the airport tax, which is designed to provide 0.8 percent of GDP in additional revenue. According to the IMF schedule, the GOM was to have enacted the business profits tax by year end 2009, and it should contribute 1.6 percent of GDP in 2010. The Asian Development Bank helped draft a business profits tax law in 2004, but the new tax has never been approved by the parliament. Minister of State for Finance and the Treasury As-Ad noted that the parliament is in recess until February 28, but he hopes that parliament will pass the Business Profits Tax bill soon. As-Ad hopes that the GOM can begin to collect the business profits tax revenue for the last half of 2010, even if they did not get the full year. A private sector contact was much

more skeptical when the business profits tax would be approved or when real revenue could be collected. The IMF plans for the GOM to implement the ad valorem tax on tourism by October 2010, but this seems much further off. The GOM currently charges an 8 USD per night bed tax, which is easy to calculate and collect, regardless of whether the hotel costs 50 or 5,000 USD per night. A senior GOM official told econoff that it would be difficult for the GOM to approve any new taxes in 2010 and the ad valorem tax was "unlikely to happen."

¶11. (SBU) The GOM is counting on substantial income from privatization, but it is unclear when or if additional government projects can be privatized. The GOM successfully sold a stake in the telecommunications company for 40 million USD in October 2009 and hopes to privatize the airport in ¶2010. Mathai of the IMF stated that the 2010 Maldives budget assumes revenue of 1.3 billion Rf from privatizations (100 million USD or 7 percent of GDP) in privatization revenue. The GOM included a similar amount of privatization revenue in their 2009 budget, but only received the telecommunications revenue.

Technical Constraints Will Limit New Tax Collections

¶12. (SBU) The GOM will need to improve its technical capacity to collect the business profits tax and ad valorem tax, which will take time to develop. The Maldives currently collects import duties (65 percent of revenue), the flat 8 USD bed tax on tourist (20 percent of revenue), and assorted other taxes such as lease payments for resort islands, royalties on foreign direct investment and foreign businesses, and a bank profits tax. Maldivian companies, such as traders and restaurants, do not pay any taxes, other than import duties which are already included in the local prices. An advisor for the US Treasury found that the Maldives Department of Inland Revenue primarily has a cashier function, collecting fixed amounts, rather than auditing businesses. The banks profits tax is analogous to the business profits tax, but there are only six banks in the Maldives, and it is unclear how thoroughly they are audited. For example, at one point

the Department of Inland Revenue realized that they were six years behind in auditing the banks for the bank-profits tax. The DIR caught up in four to six weeks, raising the question of the level of their audit. The US Treasury advisor thought that there were capable people in the DIR, but they were not trained to do proper audits. The Asian Development Bank plans to provide technical assistance to train the DIR, but the Treasury advisor thought that it would be useful to phase in the tax, giving the DIR and the Maldivian private sector time to comply, since local businesses and the DIR had limited expertise to date. Although this suggestion makes sense from a tax collection angle, it would introduce another delay into the IMF schedule.

The IMF Changes its Tune

¶13. (SBU) Post previously reported how difficult it would be for the Maldives to meet the proposed IMF targets (see reftel B). IMF representative Mathai now realizes that it would be very challenging, since although the GOM had good intentions, given the political circumstances it would be very hard for a new democracy to make these types of budget and employment cuts. Mathai asked whether the USG had any budget-support funding to ease the transition. Econoff explained that no USG funds had been allocated for this purpose.

COMMENT

¶14. (SBU) Minister of State for Finance and Treasury As-Ad realizes that the Maldives is behind schedule, and he pleaded that the IMF should "show some tolerance" for the GOM in its efforts to meet the very difficult targets. The GOM is already facing heat for complying with the preconditions on the wage rollback and the increasing electricity prices, and it has yet to face the real pain of the IMF program adjustments. Although the GOM clearly has to make radical adjustments in its government spending, the IMF does need to

show some tolerance as the GOM tries to implement this demanding IMF program.

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